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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1936.

No. 404.

THE PEOPLE OF THE STATE OF NEW YORK
upon the Relation of Annie Cohn,
Appellant,

*v.*

MARK GRAVES, JOHN J. MERRILL, and JOHN P. HENNESSEY, as Commissioners constituting the State Tax Commission of the State of New York,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NEW YORK

## APPELLANT'S REPLY BRIEF

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On Appeal from the Supreme Court of the State of New York

## APPELLANT'S REPLY BRIEF

### Appellant's Basic Contention

The appellant wishes to re-emphasize this fundamental proposition: A state cannot tax land outside its borders. The *Pollock* case decided that a tax on the income from land was a direct tax equivalent to a tax on the land. Therefore, a state cannot tax the income from land located outside its borders.

The government contends that the New York income tax here imposed is an excise tax. But that is in effect the very contention rejected by the Supreme Court in the *Pollock* case. The Supreme Court decided in the Pollock case that since a tax on the income from land was a direct tax on the land, it could not be an *indirect* or excise tax.

We believe all discussion of the protection afforded by New York State as a basis for the imposition of tax on foreign realty irrelevant. Admittedly New York either gives protection or stands ready to do so. It may exact a consideration for such protection in the form of taxation. But it may not tax the income from the foreign realty. To do so is to tax the foreign realty. *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429 (1895). This is plain unadorned extraterritorial taxation. Whatever tax payment New York may exact for its protection afforded and privileges granted, such tax may not take the form of a tax which is in effect a tax on foreign realty.

## Appellees' Cases Distinguished

In support of their position, the appellees rely strongly upon the cases of *Lawrence* v. *State Tax Commission,* 286 U. S. 276 (1932), and *Maguire* v. *Trefry,* 253 U. S. 12 (1920). An illuminating discussion of those cases and of domiciliary income taxation is set forth by Professor Arthur Leon Harding* of Southern Methodist University School of Law, which we append to this brief (Appendix A, pp ). These two cases can be clearly distinguished from the instant case.

### *Lawrence* v. *State Tax Commission.*

The tax in that case was, as Mr. Justice STONE said, "imposed by Mississippi on its own citizen with reference to the receipt and enjoyment of income derived from the conduct of *business* regardless of the place where it is carried on." (Italics ours.) The case involved the taxation by Mississippi of the income from a contract to build roads in another state. The fact that the roads were to be built in

*Double Taxation of Property and Income, Harvard Univ. Press (1933) pages 214-229.

another state did not definitely fix a property situs in such other state. Presumably the source of income in this case was the services which followed the person of the taxpayer. This is made clear in a recent decision in *Whitney, People of the State of New York ex rel.* v. *Graves*, decided by this Court January 4, 1937. As the Court there says, we are indulging in a metaphor when we speak of the business situs of intangible property in the taxing state. We express "the idea of localization by virtue of the attributes of the intangible right in relation to the conduct of affairs at a particular place." The "dominant attribute" of the taxpayer's right in the *Lawrence* case was linked to the taxing state of Mississippi.

The stock exchange seat in the Whitney case was held to have a business situs in a state of which the taxpayer was not a resident; *a fortiori*, in the instant case, the situs of the real estate being even more definitely fixed, it has a situs in New Jersey, not New York. It follows inescapably from the Pollock decision that New York may not tax the income from such property because to do so would be taxing the property.

*Maguire* v. *Trefry.*

Whether or not this case has been discredited by the *Senior* v. *Braden* and other cases, there is, nevertheless, a basic point of distinction between *Maguire* v. *Trefry*, and the instant case. The income received by the taxpayer in the *Maguire* case came from a trust; the trustee received income from ~~seat~~ personal estate in Philadelphia and transmitted the income to the taxpayer in Massachusetts. An entity intervened between the personal property located in the foreign state and the taxpayer. This means that the case is not in conflict with the *Pollock* decision, which holds that a tax on income is a tax on the property from which the income is derived, and in effect forbids the tax imposed in this case. The tax in the case of *Maguire* v. *Trefry*

was not upon the income from personal property located in the foreign state but upon the income from the equitable *interest* owned by the taxpayer in a trust, which in turn owned the securities. The taxpayer in *Maguire* v. *Trefry* was not receiving income from personal or real property owned by him in Pennsylvania; he was receiving income as a result of his ownership of an equitable interest, which, as intangible property, could as well, or even more logically, have its situs in Massachusetts, the state of the taxpayer's residence, as in the foreign state. The court said, in part, at page 16:

> "It is true that the legal title of the property is held by the trustee in Pennsylvania. But it is so held for the benefit of the beneficiary of the trust, and such beneficiary has an equitable right, title, and interest distinct from its legal ownership."

In the instant case there was no intervening trustee. The taxpayer had direct legal ownership of the New Jersey real estate. She did not, as in the *Maguire* case, receive income from the ownership of an equitable right, which could be argued to have its situs in the state of taxpayer's residence.

Appellees also rely upon the following cases, which are, however, clearly distinguishable from the case at bar.

*Cook* v. *Tait.*

Appellees, citing *Cook* v. *Tait* (1923), 265 U. S. 47 (Brief, pp. 34-36), say: "Certainly, land in New Jersey enjoys no greater immunity from taxation by New York than does land in Mexico from taxation by the United States * * *." They conclude their argument on this proposition with the statement (Brief, p. 35) "* * * But the conclusion, that this Court could not have ruled as it did in *Cook* v. *Tait*, *supra*, with respect to Federal taxation of income from Mexican lands if the Pollock case decided that a tax on rental income was a tax on the land producing such income, is, we

submit unanswerable. (See also *Cotterman* v. *United States* [1926], 62 Ct. Claims 115, certiorari denied 273 U. S. 732.)"

This argumentation, we submit, is a superb example of a perfect *non sequitur*. The United States is not limited by the 5th Amendment in the manner in which the States are by the Fourteenth Amendment. The sovereignty of the United States is such, that unless restricted by principles of international law or by treaty, it may tax a citizen of the United States residing in Mexico on income from real and personal property permanently located within the territorial jurisdiction of Mexico or derived from sources in any country of the world. The State of New York, however, and every other State in the Union, must abide by the limitations of the Fourteenth Amendment. Of course, the Supreme Court ignored the Pollock case in its decision in *Cook* v. *Tait*, *supra*, as it had absolutely no bearing upon the issue involved. (*United States* v. *Bennett*, 232 U. S. 299.)

*Central Union Trust Company* v. *Wendell.*

Appellees quote (Brief, pp. 17, 18) from *Peo. ex rel. Central Union Trust Company* v. *Wendell* (1921), 199 App. Div. 131, affd. 231 N. Y. 629, in reference to the nature and effect of the New York income tax. In this case the question at issue was the taxability for income tax purposes, under the provision of Art. 16 of the Tax Law, of interest derived from bonds secured by mortgages *upon real property situated within the State of New York*, upon which mortgages a recordation tax had been paid as prescribed by the provisions of Art. 11 of the Tax Law. It is noteworthy that the appellees fail to quote the following excerpt from the opinion:

> "We are not unmindful that it has been held that a tax on income is in reality a tax on the property producing the income. Pollock v. Farmers' Loan & Trust Co., 157 U. S. 581, 15 Sup. Ct. 673, 39 L. Ed. 759; Id. 158

U. S. 601, 15 Sup. Ct. 912, 39 L. Ed. 1108; Hancock Comptroller v. Singer Manufacturing Co., 62 N. J. Law, 289, 342, 41 Atl. 846, 42 L. R. A. 852; Opinion of the Justices, 220 Mass. 613, 623, 108 N. E. 570. That might be important in reference to some questions; as, for instance, if we were considering the legality of a tax on income, there being a constitutional prohibition against such tax on the principal. Our problem here, however, is one of statutory construction, and to ascertain the legislative intent, and in a problem of that nature we are not hampered by constitutional restrictions. In our view of sections 251 and 253 of the Tax Law, it is as if the Legislature had said there shall be no other tax on the principal of mortgages, except the recording tax; but we reserve the right to impose in the future, should circumstances require, a tax on the income of such mortgages. If we have properly construed such legislation the validity of the tax in question necessarily follows."

*McCulloch* v. *Maryland.*

We agree with the quotation from the case of *McCulloch* v. *Maryland* (1819), 4 Wheat. 316, (Brief, p. 32), but nowhere does the Chief Justice say or intimate that a State may tax a resident on extra-territorial property or on the income derived therefrom or that said property or income may be used as a measure by the domiciliary State.

*Van Rensselaer* v. *Dennison.*

The appellees cite the case of *Van Rensselaer* v. *Dennison,* (1850) 8 Barb. 23, and quote therefrom (Brief, pp. 33-34). This case involved the construction of a lease and has no application to the issue herein. The State of New York has a perfect right to tax real estate within its borders and also income therefrom. That is not double or multiple taxation in the sense in which we are using it. In this brief, we employ the term double taxation in the sense of multiple State taxation.

## Intermingling of Income Does Not Justify Right to Tax Foreign Real Estate

Appellees make the point (Brief, p. 37) that the New York income tax reached appellant's income from the extra-territorial property after the particular item of income has lost its identity by becoming intermingled with and part of the resident's entire net income from all sources.

The same contention was raised by the Attorney General in the *Pollock* case (*supra*) and was effectively answered by the late Hon. Joseph H. Choate*, one of the eminent counsel in that case.

## Business Situs in New Jersey Distinguishes This Case From Kirtland v. Hotchkiss and Justifies Non-Taxability of Interest From Bonds and Mortgages on New Jersey Real Estate.

Appellees quote (Brief, pp. 37-38) from *Kirtland* v. *Hotchkiss* (1879), 100 U. S. 491. We are in entire accord with this decision. It differs from the instant case, in that the bonds and mortgages and real estate in New Jersey in which

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"Let me call your Honors' attention again to what the learned Attorney General says. He says: 'Well, when a man has got the money in his pocket it is no longer rent.' One thing I would say about that, is that if you are going after the rent as money, the tax is on personal property and should be apportioned, as I think I shall demonstrate by and by. But the answer is that the tax does not go after the rent as money in the taxpayer's pocket. The Act of 1894, (§ 27) specifies the rents as a cardinal part and element of this income return, and every man who goes up to make his return has to state under oath what rent he got last year.

This fiction—this difference between the name and the thing, between the substance and the shadow—urged by the Attorney General is that, though you cannot tax rent, you can tax money in the owner's pocket received from rent. If there is one factitious argument, one pretense of a reason, one attempt to make a distinction without a difference that this Court has uniformly stamped upon with all its might, it is just that. This Court has repeatedly decided that such an argument is wholly unsound. * * *"

the appellant had a life interest (during her widowhood) had a business situs in the State of New Jersey. Appellant's testator died in February, 1913, in Paterson, New Jersey. Since that time the estate, managed by the three executors, of whom appellant was one, conducted the entire business of the appellant at the office of the estate in Paterson, New Jersey, managing (with all its implications) the several properties and bonds and mortgages. The agents were paid $500.00 annually (R. p. 8).

The entire managment of appellant's estate at the New Jersey office for twenty years by agents who were employed and paid by her, the fact that a New Jersey office and agents were required and the duration of said management, we respectfully submit spell out a business situs in New Jersey. The actual facts of this particular case argue strongly against the taxation imposed. Taxpayer's property, real and personal, located in New Jersey, admittedly received no protection from the State of New York. Even her mortgages could not be foreclosed in New York and no suit could be instituted in that State on bonds accompanying same, because under the law of the State of New Jersey,* no action could be brought on the bonds until the mortgages had been foreclosed.

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*N. J. Comp. Stats. Vol. 3, p. 3421.

48. *Procedure on bond where debt is not satisfied by foreclosure; limitations.*—Sec. 2. That in all cases where a bond and mortgage has or may hereafter be given for the same debt, all proceedings to collect said debt shall be, first, to foreclose the mortgage, and if at the sale of the mortgaged premises under said foreclosure proceedings the said premises should not sell for a sum sufficient to satisfy said debt, interest and costs, then and in such case it shall be lawful to proceed on the bond for the deficiency, and that all suits on said bond shall be commenced within six months from the date of the sale of said mortgaged premises, and judgment shall be rendered and execution issue only for the balance of debt and costs of suit.

## Statement as to Credit and Receipt of Income

Appellees' state (Brief, p. 2), that appellant in two places in her brief states that the income under consideration was received "or credited to her account", and that they cannot discern the pertinence or importance of the quoted words; also that they are unable to find anything in the record to support any inference that the income in question was not actually received by appellant.

The income tax return forms prescribed by the appellees and filed by the appellant for the years 1931 and 1932, contained the following instruction:

> "(24) INCOME FROM PARTNERSHIPS, ESTATES, AND TRUSTS —Report your entire share (whether distributed or not) of the profits of the partnership (including salary and interest) or of the income of the estate or trust, not merely the amount withdrawn by or paid to you."

In answer thereto appellant reported the amount of her income, without specifying that any part thereof was withdrawn by or paid to her, and that the estate was "Est. of Marcus Cohn, dec'd, No. 112 Ellison St., Paterson, N. J., Annie Cohn, Executrix, same address".

The appellant's income tax returns for the years 1931 and 1932 and also her returns as executrix of the Marcus Cohn estate, although not printed in the transcript of record, were made a part of the Record (R. 13, par. 3).

The claims for refund (R., pp. 6-9), which were predicated on appellant's returns, did not indicate that she ever received a single dollar in the State of New York; and nowhere in the Record does it appear that appellant ever had a bank account in the State of New York.

An examination of each of appellant's income tax returns filed as executrix of said estate contains the following statements under DEDUCTIONS. on page 2 (18) of the return. "Commissions paid to agents for management of props—

$500." And in the claims for refund (R., p. 61, last line) and (R., p. 8, fol. 13, last line), there appears a deduction of $500 for agents.

As appears from the Record, pages 14-15, the entire income of the Marcus Cohn estate was collected by the executors of the estate, or agents of appellant, from the real estate and bonds and mortgages, physically located and secured by real estate in Paterson, N. J., where an office was maintained since 1913.

## Retroactivity of the Tax

The appellees state (brief, p. 8) that the 1935 amendment imposed no new or different tax than the tax previously assessed and collected for many years. In support of this statement, appellees say:

> "* * * ever since the inception of the Income Tax Law in 1919, the State Tax Commission had imposed taxes upon income received in the form of rents from real estate located without the State."

It is obvious that the imposition of the tax by the State Tax Commission did not mean that the tax was legally imposed. The case of *Pierson* v. *Lynch,* 263 N. Y. 533, *cert. den.,* 293 U. S. 52 (193 ), decided, in effect, that there had never been a New York income tax on the rents from foreign real estate. The practice of the State Tax Commission must bow to the superior authority of the New York Court of Appeals. The appellees say that the retroactive amendment of the statute was for the purpose of making clear the legislative intent. Evidently, then, the legislative intent was not clear prior to this amendment. How can the government confidently and dogmatically argue that this tax has been in existence since 1919?

Appellant does not argue that all retroactive tax legislation is invalid, but only excessive, unreasonable and arbitrary retroactivity.

The recent case of *United States* v. *Hudson,* decided Jan'y 11, 1937, sets forth very clearly the principle upon which this court acts. In that case the period of retroactivity was 35 days, which this court held not unreasonable. But in the case at bar the period of retroactivity runs back sixteen years to 1919.

Respectfully submitted,

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# Appendix A

## Double Taxation of Property and Income

A study in the judicial delimitation of the conflicting claims of taxing jurisdiction advanced by the American States.

*by*

Arthur Leon Harding
*Member of the Texas Bar*
Associate Professor of Law, Southern Methodist University School of Law.

Harvard University Press
1933

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46. Domiciliary Income Taxation: The State of Decision. Judicial decisions involving the right of the domiciliary State to tax the local recipient upon income clearly from foreign sources are in a state of confusion. As we have seen, most of the cases are concerned with the hopeless task of classifying the income tax in terms of some one of the more familiar taxes, and have given little attention to the limitations implied in such classification. In these cases, the principal effort has been directed toward circumventing various constitutional provisions drafted prior to the popular acceptance of the income tax.[266] However, we have some State authority which involves directly this issue of domiciliary taxation of foreign income. In *Crescent Manufacturing Co.* v. *Tax Commission*[267] the South Carolina Court affirmed a general right of domiciliary taxation, largely upon the theory that the tax was based upon per-

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[266] These cases are collected *supra*, notes 24, 25, 27.

[267] 129 S. C. 480, 124 S. E. 761 (1924).

sonal allegiance rather than upon situs. The Mississippi Court, in two not very distinguished opinions, has reached much the same result.[268] To the contrary we have an advisory opinion of the New Hampshire Court holding that the State was without constitutional authority to tax a resident individual upon income received by him from foreign land or from chattels situated outside the State.[269] The Massachusetts Court, in the significant case of *Hutchins* v. *Commissioner of Corporations and Taxation,*[270] rejected as probably unconstitutional a statutory construction which would allow a resident trustee to be taxed upon the income from a foreign administered and foreign appointed trust. Finally, we find that the Hawaiian Court has held that the Territory is without constitutional authority to tax a resident individual upon income from credits with a business situs elsewhere.[271] These cases from New Hampshire, Massachusetts, and Hawaii were decided upon the basis of *DeGanay* v. *Lederer*[272] and the inheritance tax cases beginning with *Farmers Loan and Trust Company* v. *Minnesota,*[273] and involve reasoning very closely akin to

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[268]State v. Gulf, M. & N. R. Co., 138 Miss. 70, 104 So. 689 (1925); Lawrence v. State Tax Commission, 162 Miss. 338, 137 So. 503 (1931).

[269]In re Opinion of the Justices, 84 N. H. 559; 149 Atl. 321 (1930). See also People ex rel. Pierson v. Lynch (N. Y. App. D. 1933) 263 N. Y. S. 259, holding that a resident of New York was not there taxable on income from rental of foreign land, but that he was taxable on profit from the sale of such land. The reason for the distinction is obscure.

[270]272 Mass. 422, 172 N. E. 605 (1930); 44 *Harv. L. Rev.* 475 (1931); 31 *Col. L. Rev.* 173 (1931); 79 *U. Pa. L. Rev.* 219 (1930).

[271]Carter v. Hill, 31 Haw. 264 (1930); Hill v. Carter (C. C. A. 9th 1931) 47 F. (2d) 869; cert. den., 284 U. S. 625, 52 S. Ct. 10, 76 L. ed. 532 (1931).

[272]250 U. S. 376, 39 S. Ct. 524, 63 L. ed. 1042 (1919); *supra,* sections 38 and 39.

[273]280 U. S. 204, 50 S. Ct. 98, 74 L. ed. 371 (1930); *supra,* section 6.

that here advanced. It is also significant that the South Carolina case and the first of the Mississippi cases were decided prior to *Farmers Loan and Trust Company* v. *Minnesota*. Thus there is but the one case, *Lawrence* v. *State Tax Commission*,[274] decided in a State court after 1930 which upholds a claim of general taxing jurisdiction over income at the domicil. This case will be further discussed below.

When we turn to the United States Supreme Court cases we find that the situation is no better settled. There are two cases, *Maguire* v. *Trefry*[275] *and Lawrence* v. *Mississippi*.[276] Those we must consider in detail.

In *Maguire* v. *Trefry* the Supreme Court held that a resident beneficiary of a foreign administered trust of intangibles might be taxed upon the income received from the trust estate. To attain this result the Court advanced five different reasons:

(*a*) That the tax was essentially upon the income as property, after it actually came within the State.

(*b*) That the principles formulated in the *United Transit*[277] case did not apply to intangibles.

(*c*) That it was immaterial that this wealth was subject to taxation elsewhere; that double taxation was not violative of the United States Constitution.

(*d*) That this wealth was incident to the equitable estate of the *cestui*, which was intangible property and thus had a taxable situs at his domicil.

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[274] *Supra*, note 268.

[275] 253 U. S. 12, 40 S. Ct. 417, 64 L. ed. 739 (1920).

[276] 286 U. S. 276, 52 S. Ct. 556, 76 L. ed. 1102 (1932); affirming Lawrence v. State Tax Commission, *supra*, note 268.

[277] *Supra*, section 1.

(*e*) That the State of domicil protected the recipient of the income.

This was in 1920. To-day not a single one of these reasons is sufficient to support the tax. Taking the reasons in turn we find that much, very much, has occurred in the thirteen-year interval:

(*a*) It is admittedly the right of the State to tax income as property as soon as it comes within the State, provided of course there is no discrimination because of its extra-State origin. This, however, does not justify the taxation of the income at a rate materially different from that imposed upon other property. Nor does it justify taxation at a progressive rate rather than the flat rate ordinarily incident to the ad valorem tax. The State constitutions are sufficient to prevent such a discrimination if the income tax be treated as a mere substitute ad valorem tax,[278] and the Federal equal protection clause is becoming increasingly important in this regard.[279]

(*b*) The principles of the *Union Transit* case have, within the last few terms of court, been extended to cover a number of intangibles, and further extension along the same line seems imminent.[280]

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[278]See Eliasberg Bros. Merc. Co. v. Grimes, 204 Ala. 492, 86 So. 56, 11 A. L. R. 300 (1920). That the Alabama Court erred in its classification of the income tax seems reasonably clear. See Rottschaefer, A State Income Tax and the Minnesota Constitution, 12 *Minn. L. Rev.* 683 (1929). If, however, we assume the correctness of this classification, the decision on the uniformity issue seems sound.

[279]See Southwestern Bell Telephone Co. v. Middlekamp, 1 F. (2d) 563 (1921). This case was based upon a misunderstanding of the Missouri statute. See St. Louis San Francisco R. Co. v. Middlekamp, 256 U. S. 226, 41 S. Ct. 489, 65 L. ed. 905 (1921).

[280]*Supra*, section 6.

(c) It is now declared that double taxation of the same legal interest or wealth by two different States on the basis of conflicting theories may, if unreasonable, be opposed to the due process clause."[27]

(d) It is now held that the *cestui* of a trust in intangibles does not have a property right in intangibles which may be taxed to him at his domicil, notwithstanding that the entire value of the property has been taxed at its situs and at the domicil of the legal owner."[28]

(e) The last reason, thrown in as a sort of makeweight, was not entitled to credit at the time of the decision. The courts had held, beginning with the *Union Transit* case, that protection afforded the person of the owner could not be relied upon to establish jurisdiction to tax property actually situated outside the territorial limits of the State. Protection afforded the person is absolutely immaterial in determining a question of taxing jurisdiction over property.

It thus appears that the first reason advanced, designed to save the decision as a tax on property, encounters constitutional difficulties of equality and uniformity."[29] The next three reasons, however true they may have been in 1920, have since fallen from grace. The next and last

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[27] Farmers Loan & Trust Co. v. Minnesota, *supra*, note 273; First National Bank v. Maine, *supra*, note 227; see generally section 6.

[28] Safe Deposit & Trust Co. v. Virginia, 280 U. S. 83, 50 S. Ct. 59, 74 L. ed. 180, 67 A. L. R. 386 (1929); 42 *Harv. L. Rev.* 712 (1929); 27 *Mich. L. Rev.* 827 (1929); 15 *Va. L. Rev.* 696 (1929); *supra*, sections 20 and 39.

[29] Southwestern Bell Telephone Co. v. Middlekamp, *supra*, note 279. The growing importance of the equal protection clause of the United States Constitution in matters of this sort is obvious. See Southern Railway v. Greene, 216 U. S. 400, 54 L. ed. 536, 30 S. Ct. 287 (1910); Hanover Fire Insurance Co. v. Harding, 272 U. S. 494, 47 S. Ct. 179, 71 L. ed. 372, 49 A. L. R. 713 (1926); 35 *Cal. L. Rev.* 316 (1927); 40 *Harv. L. Rev.* 777 (1927).

reason was invalid when advanced, and is still more obviously invalid to-day. The standing of *Maguire* v. *Trefry*[284] is thus rendered highly problematical, if the case has not been entirely destroyed. Certainly there is nothing about its present unenviable position to justify any great optimism as to its future. Certainly this case standing alone cannot establish a general income tax jurisdiction at the domicil. In fact it was never intended to, its principal reliance being upon the idea that the source of the income was the equitable estate of the *cestui*, which might at that time have been said to have a situs at his domicil.[285]

In *Lawrence* v. *Mississippi*[286] the question is again presented, but in slightly different form. Here the State of Mississippi sought to tax a resident of that State upon income in the form of profits accruing from a road-building contract performed in Tennessee. This was upheld in the State Supreme Court.[287] On appeal to the United States Supreme Court, counsel for the appellant unfortunately briefed the case upon a theory that the tax was a simple excise or occupation tax upon the profession of road-building. This contention the appellee refuted without great difficulty, and the decision of the lower court was affirmed, Mr. Justice Stone, for the Court, saying:

> The tax, which is apportioned to the ability of the taxpayer to bear it, is founded upon the protection

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[284]*Supra*, note 275.

[285]*Supra*, sections 20 and 39. The faith of the Massachusetts Court in this case seems to remain unshaken. First National Bank v. Comm., ——— Mass. ———, 181 N. E. 205 (1932).

[286]286 U. S. 276, 52 S. Ct. 556, 76 L. ed. 1102 (1932); affirming, 162 Miss. 338, 137 So. 503 (1931).

[287]Upon the basis of Hattiesberg Grocery Co. v. Robertson, *supra*, note 24, and State v. Gulf, M. & N. R. Co., *supra*, note 268.

afforded to the recipient of the income by the State, in his person, in his right to receive the income, and in his enjoyment of it when received.[288]

Mr. Justice Stone's argument may be summarized as follows:

(*a*) Domicil within the State, involving the privilege of residence within the State and the right to invoke the protection of the laws of the State, constitutes a basis for taxation.

(*b*) The State is unrestricted in its taxation of those domiciled within its limits "*so long as the tax imposed is upon property within the State or on privileges enjoyed there,* and is not so palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment." (Italics ours.)

(*c*) "Taxation at the place of domicile of tangibles located elsewhere has been thought to be beyond the jurisdiction of the State;[289] but considerations applicable to ownership of physical objects located outside the taxing jurisdiction, which have led to that conclusion, are obviously inapplicable to the taxation of intangibles at the place of domicile or of privileges which may be enjoyed there."

(*d*) Whether the State calls the tax an excise or property tax is immaterial in determining whether the property or privilege is within the jurisdiction of the taxing State.

(*e*) The tax "is founded upon the protection afforded to the recipient of the income by the state, in his person, in

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[288]286 U. S. 276, at 281.

[289]Citing Union Refrigerator Transit Co. v. Kentucky, 199 U. S. 194, 26 S. Ct. 36, 50 L. ed. 150 (1905); Frick v. Pennsylvania, 268 U. S. 473, 45 S. Ct. 603, 69 L. ed. 1058, 45 A. L. R. 316 (1925); both *supra,* section 1.

his right to receive the income, and in his enjoyment of it when received. These are rights and privileges incident to his domicile in the state and to them the economic interest realized by the receipt of the income or represented by the power to control it bears a direct legal relationship."

(*f*) "It would be anomalous to say that although Mississippi may tax the obligation to pay appellant for his services rendered in Tennessee, still, it could not tax the receipt of the income upon payment of that same obligation."

Each of these steps and reasons should be noted in detail.

If we take this reasoning, in the order in which it appears, we may make the following observations:

(*a*) We may concede with Mr. Justice Stone that domicil constitutes one basis of taxation. The difficulty we face is in defining its limits.

(*b*) We also concede the truth of the second proposition. However, the condition attached thereto is most important, and states that the tax must be based upon property within the jurisdiction of the State or upon privileges enjoyed there. Our present task is to determine whether, in the instant case, there is such property or privilege as will support this tax at the domicil.

(*c*) Here we must pause. Mr. Justice Stone takes the position that the principles which have precluded domiciliary taxation of chattels situated outside the State have no hearing on the taxation of intangibles at the domicil. This does not appear to be true. The principle which is to be deduced from the *Union Transit* and *Frick* cases would seem to be this: that where an object of wealth is found to have a situs in fact in a single place, it is not to be subjected to taxation at another place, not even at the

domicil of the owner, on the basis of legal fictions which have no relation to, or are opposed to, fact. If we re-examine *Farmers Loan and Trust Co.* v. *Minnesota,*[290] *Baldwin* v. *Missouri,*[291] and *First National Bank* v. *Maine,*[292] we find the Court announcing in each of these cases that the principle of the *Union Transit* case must now be applied to intangibles, to the end that harsh, oppressive double taxation of intangibles may be eliminated.[293] We find the Court stating in each case that it is no more possible for an intangible to have a legal situs at two places than it was possible for a chattel to be in two places at the same time.[294] Having determined in each of these cases that the principles of the *Union Transit* and *Frick* cases *did* apply to the taxation of intangibles, the Court then turned to the problem of finding the single legal situs which was to

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[290]280 U. S. 204, 50 S. Ct. 98, 74 L. ed. 371, 65 A. L. R. 1000, *supra,* sections 6 and 14.

[291]281 U. S. 586, 74 L. ed. 1056, 50 S. Ct. 436, 72 A. L. R. 1303, *supra,* sections 6 and 17.

[292]284 U. S. 312, 52 S. Ct. 174, 76 L. ed. 313 (1932), *supra,* sections 6 and 19.

[293]"Tangibles with permanent situs therein, and their testamentary transfer, may be taxed only by the state where they are found. And, we think, the general reasons declared sufficient to inhibit taxation of them by two states apply under present circumstances with no less force to intangibles with taxable situs imposed by due application of the legal fiction. . . . Certainly, existing conditions no less imperatively demand protection of choses in action against multiplied taxation whether following misapplication of some legal fiction or conflicting theories concerning the sovereign's right to exact contributions." McReynolds, J., in Farmers Loan & Trust Co. v. Minnesota, 280 U. S. 204, at 211. "The rule of immunity from taxation by more than one state, deducible from the decisions in respect of these various and distinct kinds of property [land, chattels, bonds, notes and credits], is broader than the applications thus far made of it." Sutherland, J., in First National Bank v. Maine, 284 U. S. 312, at 326.

[294]"Due regard for the processes of correct thinking compels a conclusion that a determination fixing the local situs of a thing for the purpose of trans-

be preferred. The Court found in each case, as regards the particular property in question, debts, bonds, bank accounts, negotiable instruments, and corporate stock, that the maxim *mobilia sequantur personam* was not opposed to fact sufficiently to prevent taxation at the domicil, and that taxation at the domicil was to be preferred over taxation by a State which, although affording protection, could not establish the fact of situs therein. However, in each of these cases, as well as in *Beidler* v. *South Carolina*,[295] the Court expressly refused to state that the *mobilia* maxim was all-inclusive, and at the same time excluded or reserved from the operation of the decision the taxation of intangibles with a business situs.[296] It appears then that Mr. Justice Stone is clearly in error in concluding from these former opinions that the principles of the *Union Transit* case do not apply to intangibles, and in concluding from the same cases that the taxing power of the domicil extends to *all* intangibles.[297]

(*d*) We may well admit with Mr. Justice Stone that the particular name or title which the State may attach to the

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ferring it in one state carries with it an implicit denial that there is a local situs in another state for the purpose of transferring the same thing there. The contrary conclusion as to intangible property has led to nothing but confusion and injustice by bringing about the anomalous and grossly unfair result that one kind of personal property cannot, for the purpose of imposing a transfer tax, be within the jurisdiction of more than one state at the same time, while another kind, quite as much within the protecting reach of the Fourteenth Amendment, may be, at the same moment, within the taxable jurisdiction of as many as four states, and by each subjected to its transfer by death, an event which takes place, and in the nature of things can take place, in one of the states only." Sutherland, J., in First National Bank v. Maine, 284 U. S. 312, at 326.

[295]282 U. S. 1, 51 St. Ct. 54, 75 L. ed. 131 (1930).

[296]See generally sections 6 and 20, *supra*.

[297]Howard, Recent Developments and Tendencies in the Taxation of Intangibles, *Univ. of Mo. Law Series*, No. 44, p. 1 (1931).

tax is immaterial when passing upon the question of jurisdiction, however the case may be in connection with other questions.[298]

(*e*) Mr. Justice Stone here bases his argument upon protection afforded the taxpayer and divides this protection into three heads: protection afforded the person of the taxpayer, protection afforded the right to receive the income, and protection afforded the enjoyment of it when received. We may examine each of these heads separately.

The first, that of protection afforded the person of the taxpayer, we have seen to be of no value in determining taxable situs of property. In the first place the protection afforded the person is the same regardless of the amount of property which he may own outside the State.[299] It has been recognized that, just as the State cannot tax the individual upon chattels actually situated outside the State, it cannot accomplish this same result by taxing the individual on the basis of personal protection, but measuring the tax by the value of property outside the taxing jurisdiction of the State.[300] This fact has been the great stumbling-block of the protection theorists. It is true that protection of the person affords a basis of taxation, but it is absolutely useless in determining whether particular property is or is not within the jurisdiction of the taxing State, or in determining whether that State may or may not reach a particular source of taxation.

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[298]We have already considered the effect of the name of the statute upon the power of the State to reach income which might, for some reason other than lack of jurisdiction, be exempt from the ordinary income tax. Cases cited *supra*, notes 252-254.

[299]See *supra*, section 4, for a discussion of this protection notion.

[300]Union Refrigerator Transit Co. v. Kentucky, *supra*, note 289. See generally sections 1, 20, 31, and 44, *supra*.

The second head of protection mentioned is protection given by the State of domicil to the right to receive the income. In the first place we may well doubt whether such protection is given by the State of domicil more than by any other of the forty-eight States. It would seem that this protection would be given primarily at the place where the work was done, or where the debtor might be sued, or where the debtor has property. It is clearly settled by this time that the right to tax cannot be predicated upon the ground that the courts of the taxing State stand ready to give legal efficacy and enforcement to the obligation sought to be taxed. This theory of taxation was at the basis of the Holmesian control theory advocated in *Blackstone* v. *Miller,*[301] and has been repudiated by the cases beginning with *Farmers Loan and Trust Co.* v. *Minnesota.*[302] Thus we appear justified in stating that even if it be assumed that the State of domicil gives some special protection to the right to receive the income,—and this is by no means clear,—still this in itself is not sufficient basis for the imposition of a tax upon the thing protected.

The third head of protection mentioned is that afforded the recipient in the enjoyment of the income. We have seen above[303] that the income *when actually brought into the domiciliary State* may be subjected to the ordinary ad valorem property tax; but this will not justify the taxation of such income when brought into the State at the progressive rates found in this and other income tax statutes. It is clear that in Mississippi,[304] as in the other States, such

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[301]188 U. S. 189, 23 S. Ct. 277, 47 L. ed. 439 (1903). See generally sections 1, 6, 14, 16, and 20, *supra.*

[302]*Supra,* note 290.

[303]*Supra,* section 43.

[304]Hattisberg Groc. Co. v. Robertson, *supra,* note 24.

a tax would encounter difficulties under the equality and uniformity provisions of the State constitutions. The Mississippi Court has specifically rejected this theory of income tax as being opposed to the State Constitution.[305] The statute shows no such legislative intention. The facts of the case show nothing as to the disposition of the income after its receipt. Although the United States Supreme Court is not bound by the definitions advanced in the State courts, it would be most unusual to find the Court sustaining the statute on a theory not advanced by the State, a theory which would make the statute unconstitutional under the State's own organic law. It also seems that in treating this income tax as a tax upon the use and enjoyment of the income as property, the Court goes beyond any reasonable definition of "income" taxation.[306] It would seem clear that the right to tax the income as property, *if and when* brought within the taxing jurisdiction of the State, is not *ipso facto* equivalent to a right to tax the income when earned and received outside the State, and perhaps never brought within the jurisdiction. Any reasoning which would make the two things equivalent seems logically untenable.

(*f*) The final step in the argument is ingenious. It is important in that it reveals that in the mind of the learned Justice there is a relationship between the power to levy a property tax on the source of the income and the power to tax the income itself. This much we may concede. But does it follow from this that the State of domicil may tax income from business done elsewhere, merely because the legal right to the income rests upon promissory obligation? In the first place, we are not prepared to admit

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[305]See also State v. Gulf, M. & N. R. Co., *supra*, note 268.

[306]*Supra*, section 31. See also section 43, and note 231, *supra*.

that the domicil may tax all wealth represented by promissory obligations. We concede the power to tax only those without an actual situs elsewhere. Where the debt or other promissory obligation may be said to have acquired a business situs, a situs by economic integration, at some place other than the domicil, it would seem that under the principles of the *Union Transit* and *Farmers Loan and Trust* cases, taxation at the domicil must be abandoned.[307] Furthermore, it would seem that this obligation has a taxable situs in Tennessee, the nondomiciliary State. The taxpayer has taken himself and his property into that State and engaged in a productive activity there for a number of months. All of the property taken in would be subject to taxation in Tennessee.[308] The person of the taxpayer could be taxed in Tennessee.[309] The business or occupation within that State could be there taxed.[310] It would seem that the intangible interests which are centered about this not entirely temporary business venture within the State are sufficiently a part of this business enterprise to be *taxable* as a part of it The ordinary case of business situs involves transactions over a period of years, and involves the lending of money; but this is not the only type. Business situs may be applied to all intangibles

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[307] *Supra*, sections 6 and 20.

[308] Gromer v. Standard Dredging Co., 224 U. S. 362, 32 S. Ct. 499, 56 L. ed. 801 (1912); Hamilton Dredging Co. v. State, 99 Ala. 462, 12 So. 720 (1893); Eoff v. Kennefick Hammond Co., 80 Ark. 138, 96 S. W. 986 (1906); Griggsby Const. Co. v. Freeman, 108 La. 435, 32 So. 399 (1902); Hamilton & Gleason Co. v. Emery Co., 75 Utah 406, 285 Pac. 1006 (1930). See generally section 11, *supra*.

[309] Haavick v. Alaska Packers Assn., 263 U. S. 510, 44 S. Ct. 177, 68 L. ed. 414 (1923); Alaska Packers Assn. v. Hendeskoy (C. C. A. 9th 1920) 267 Fed. 154, cert. den., 254 U. S. 652, 41 S. Ct. 149, 65 L. ed. 458 (1920). See generally section 25, *supra*.

[310] *Supra*, section 27.

which are the normal components of a business enterprise, not entirely transitory, which has been associated with the business activity of the place so as to acquire a taxable situs therein.[311] It seems that this test has been met in the present case, although some of the facts are in doubt. If this be true, then we must reject Mr. Justice Stone's assumption that this promise would be taxable in Mississippi. Even if the facts are not sufficient to remove this promise from the taxing jurisdiction of the State of Mississippi, must we agree that the right to tax the promise is equivalent to the right to tax the income? We may assume, on the basis of *Shaffer* v. *Carter*[312] and other cases, that the State with jurisdiction to levy a property tax on the source of the income has jurisdiction to tax the income itself. Our integration principle compels this result. However, as used in the books, the *source* of the income is not identical with the legal right or power which makes the income collectible. The source seems to be the property, labor, credit, legal right, or other wealth *owned by* and *invested* by the recipient, in respect of which he first acquired the income or the right thereto. The legally accepted definition of income presupposes that the individual has previously or contemporaneously employed some wealth of *his own* in connection with the economic activity of the social group, and that the income flows from the *capital* so employed.[313] The legal definition does not include gifts. It is the capital owned by the individual recipient which we call the source of the income. In the case of income from money loaned

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[311] An example of this sort of thing is found in the corporate excess cases. *Supra*, section 18.

[312] 252 U. S. 37, 40 S. Ct. 221, 64 L. ed. 445 (1920); *supra*, sections 33 and 34.

[313] *Supra*, sections 30 and 32.

we call the debt the source of the income, since that is the thing *owned by the recipient* in respect of which the income accrues. Realistically, of course, the source may be said to be in the money originally advanced, but that money is no longer the property of the lender, and, so far as he is concerned, is not the source of the income *to him*. So, too, in the case of corporate dividends, we say that the source is the legally created status of stockholder, since that legal status is the thing in respect of which the dividends first come to the recipient. All sources prior in time represent capital of the corporation, and not of the stockholder recipient. In the case of income from the use of land or chattels, or from the sale of land or chattels, we find the source in tangible form. The capital of the recipient, invested in coordination with the wealth of others, is the land or chattels, and constitutes the source of the income. It is in respect of this wealth that the income or the right to the income first accrues to the recipient. The subsequent steps by which he reduces this income to actual possession are not sources of the income and may be disregarded. *Shaffer* v. *Carter*[314] and the other cases agree in holding the subsequent questions of collection and payment immaterial as regards taxation at the source as here defined. In the case of personal services or labor, the capital invested is the labor and personal skill. The labor and skill constitute the sources of the income. The legal device by which payment is secured is not a source of income. In short, we must remember that the jurisdictional fact is the production of the new wealth and the creation of the right thereto in the taxpayer, and is not the formality or service of reducing this new wealth to possession. If Mr. Justice Stone means that Mississippi can tax the income because it could

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[314] *Supra*, note 312.

tax the contract, and that the contract is the source of the income, he appears to be using the word source in a manner not supportable on the basis of decided cases or of sound reasoning. If, on the other hand, he means that Mississippi, because of its control over the enforcement of the contract, can tax the income, even though the contract be not the source of the income, he is skating dangerously close to the now repudiated Holmesian idea that the power to control or to interfere with the enforcement of legal rights gives the right to tax the wealth represented by those rights. On the basis of these observations, then, it seems that the disarming declaration that "it would be anomalous to say that Mississippi may tax the obligation to pay appellant for his services rendered in Tennessee, still, it could not tax the receipt of the income upon payment of that same obligation," when examined in the light of the facts, and long settled and recently reaffirmed legal principles, carries no great amount of conviction.

On the whole, then, the *Lawrence* case does not appear to be acceptable. It has been pointed out that counsel made the unfortunate mistake of predicating his appeal on the theory that the Mississippi income tax statute was no more than an excise or occupation tax. This position was easily defeated. However, the real reason for the confusion must be found in the fact that the opinion was written by a judge whose individual views condone the older theories, with their attendant confusion and double taxation. Mr. Justice Stone, it will be recalled, wrote a dissenting opinion in *Baldwin* v. *Missouri*,[315] and wrote concurring opinions in, but disagreed with the reasoning in, *Safe Deposit and Trust Company* v. *Virginia*[316] and *Farmers Loan and Trust*

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[315] *Supra*, note 291.

[316] *Supra*, note 282.

*Company* v. *Minnesota*.[317] In these opinions he did not make himself entirely clear, but embraced first the protection theory of taxation, and then the control doctrine. However ambiguous he was on these issues, nevertheless it is clear that he stood for double taxation on the basis of legal fictions which are here believed to be untenable. The same confusion appears in his opinion in the *Lawrence* case, where, as we have seen, he argues for the tax on one point on the basis of protection, and on another on the basis of a legal power of control. The new and salutary principles found in the cases in which he dissented, he ignores. In view of these facts, it is not believed that the opinion, that is, the language in the opinion, can be taken as expressing accurately the settled conviction of the Supreme Court.[318]

When we review the cases on this point of domiciliary taxation of income, we find cases from two States[319] and from one Territory,[320] all decided after *Farmers Loan and Trust Company* v. *Minnesota*, which indicate that the domiciliary State is without power to tax income received from sources in another State, and there taxable. The reason-

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[317] *Supra*, note 290.

[318] One is reminded of a similar instance of recent occurrence. For twenty-five years after the decision in Smythe v. Ames, 169 U. S. 466, 18 S. Ct. 418, 42 L. ed. 819 (1898), the Supreme Court very carefully and forcefully refused to state that the present cost of reproduction less depreciation was a final criterion of the validity of rates to be charged by a public service company, only to have Mr. Justice Butler, in an inconspicuous portion of Indianapolis Water Company v. McCardle, 272 U. S. 400, 47 S. Ct. 144, 71 L. ed. 316 (1926), employ language which completely upset the apple-cart. The cart was righted at the next opportunity. St. Louis & O'Fallon R. Co. v. United States, 279 U. S. 461, 49 S. Ct. 384, 73 L. ed. 798 (1929).

[319] Hutchins v. Commr., *supra*, note 270; In re Opinion of the Justices, *supra*, note 269. See also People ex rel. Pierson v. Lynch, *supra*, note 269.

[320] Carter v. Hill, *supra*, note 271.

ing of those cases is here approved. Two of the three cases, it is interesting to note involved intangibles. Opposed to this view we find no creditable State authority. The South Carolina Court reached the position upholding the right to tax, but the case was decided prior to both *Farmers Loan and Trust Company* v. *Minnesota* and *Frick* v. *Pennsylvania*. Its reasoning will hardly stand examination in the light of those two Supreme Court cases. The Mississippi Court reached the same result. In the first[321] of the cases the opinion is beclouded with vain attempts to classify the tax in the existing schemes. The second[322] case is very much muddled up with a question as to the effect of a statute exempting domestic corporations from taxation on income from foreign sources. The real authority in favor of domiciliary taxation of income from sources taxable abroad is to be found in *Maguire* v. *Trefry*[323] and in *Lawrence* v. *Mississippi*.[324] We have seen that the reasoning of the first of these cases has been almost, if not entirely, cut away by subsequent decisions. We have indicated above many vital objections to *Lawrence* v. *Mississippi*. It would appear, then, that the question is far from being settled.

Fortunately the more enlightened courts in the United States have passed beyond the older English idea that a precedent, once established, must stand until changed by a higher court or by a valid statute.[325] In this country we have tended more and more to look to the reasons back of

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[321]State v. Gulf, M. & N. R. Co., *supra*, note 268.

[322]Lawrence v. State Tax Commissioner, *supra*, note 268.

[323]*Supra*, note 275.

[324]*Supra*, note 286.

[325]Salmond, *Jurisprudence* (7th ed., 1924), pp. 187-206. See Great Western Ry. Co. v. Owners of S. S. Mostyn, [1928] A. C. 57.

the precedent, to the justice inherent in it, to the history of such affairs since the date of the precedent, and to the social effect of its existence, before we decide that it is to remain inviolable.[326] If the particular precedent is unreasonable or unjust, and if the social consequences of repudiating it do not outweigh the benefits to be derived from change, we have no great hesitation about discarding it, except that we are loathe to change a precedent, not too outrageous, where it has formed the basis of a well-established custom of the community, or where it forms the basis for well-established property rights.[327] The willingness to change is particularly important in the field of constitutional law. Here we deal with vital questions of policy, in the face of ever-changing social conditions. If the Court err, there is no quick relief by statute, only the cumbersome method of constitutional amendment. A strict rule of

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[326]"A decided case is worth as much as it weighs in reason and righteousness and no more. It is not enough to say 'thus saith the court.' It must prove its right to control in any given situation by the degree in which it supports the rights of a party violated and serves the cause of justice as to all parties concerned." Wanamaker, J., in Adams Express Co. v. Beckwith, 100 Ohio St. 348, 352, 126 N. E. 300 (1919). "There should be greater readiness to abandon an untenable position when the rule to be discarded may not reasonably be supposed to have determined the conduct of the litigants, and particularly when in its origin it was the product of institutions or conditions which have gained a new significance or development with the progress of the years." Cardozo, *Nature of the Judicial Process* (1921), p. 151.

[327]"If, after thorough examination and deep thought, a prior judicial decision seems wrong in principle or manifestly out of accord with modern conditions of life, it should not be followed as a controlling precedent, where departure therefrom can be made without unduly affecting contract rights or other interests calling for consideration." Von Moschzisker, Stare Decisis in Courts of Last Resort, 37 *Harv. L. Rev.* 409, 414 (1924). "Precedents, and especially the precedent of a single case, will no longer be considered a binding source of law which judges must accept under all circumstances. Only if decided cases have created a practice upon which laymen have relied, will the American courts feel that they are bound to follow them. This, as I

*stare decisis* in matters of this sort would be intolerable.[328] The judicial method of the Supreme Court is becoming more and more one of trial and error, of judicial approximation to the spirit of the times, and of judicial satisfaction of the valid demands of the times. We have witnessed that judicial groping for truth in the matter of taxation in the long period from 1905 to 1930, and have seen the Court in 1930 formulate its conclusions, sweep the books clear of confused precedent, and set out upon the track which it believes to be sound. The opinion in *Lawrence* v. *Mississippi*[329] represents another effort to get on solid ground, but it falls short. There is no reason to believe that its mistaken inferences will be allowed to deter the Court from following the path blazed in the cases of this and the two terms next preceding.[330]

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have attempted to show, is the doctrine of the civil law and directly contrary to that of the English law with its insistence upon the need for certainty. I therefore believe that, as concerns the fundamental doctrine of precedent, English and American law are at the parting of their ways." Goodhart, *Essays in Jurisprudence and the Common Law* (1931), p. 74.

[328]"A series of decisions based upon grounds of public policy, however eminent the judges by whom they were delivered, cannot possess the same binding authority as decisions which deal with and formulate principles which are purely legal. The course of policy pursued by any country in relation to, and promoting the interests of, its commerce must, as time advances and as its commerce thrives, undergo change and development of the action of its Courts." Watson, L. J., in Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co., [1894] A. C. 535, 553, cited by Goodhart, *op. cit., supra*, note 327, at 67-68.

[329]*Supra*, note 286.

[330]See *infra*, note 422.